By email to: GEMdiscussionpaper@hkex.com.hk

Hong Kong Exchanges and Clearing Limited
12th Floor, One International Finance Centre
1 Harbour View Street, Central
Hong Kong

Attention: Corporate Communications Department
Re: Discussion Paper on GEM

c.c: others

Date: 27 April 2006

Dear Sirs,

Comments on
Discussion Paper on the Growth Enterprise Market

I would like to submit my views as hereinafter under the following headings in response to your Discussion Paper ("Paper") on the Growth Enterprise Market ("GEM").

Section 1: An Overview
Section 2: An Executive Summary
Section 3: Comments and Responses

This submission is by email and I can be contacted at the email address indicated below.

Yours truly
CK Leung
(Respondent)

Section 1: An Overview

Introduction

Hong Kong is entering into the 3rd phase of its economic development as China is emerging into a new economic power. De-regulation of the capital account of RMB is a foreseeable event for which the traditional role of Hong Kong as an international financial centre linking China and the outside world will necessarily be undergoing change. How should our capital market react to this important change is a challenge to Hong Kong in the same way as the liberation of China in 1949 and the opening door policy in the 1980s.

Concerns

The growth company market ("Growth Market") is an important economic issue worldwide. Whether our Growth Market will continue to exist or not means a fundamental change in the status of Hong Kong as an international financial centre with very important economic, legal and political significances in addition to affecting the future of our financial industry.

In connection therewith, the main concerns of the Respondent can be stated in the following manner;

(1) The importance of protection of investors required by the Securities and Futures Ordinance;

(2) Maintenance of Hong Kong as an international financial centre under the Basic Law;

(3) Campaign for the re-introduction of competition back into the stock market of Hong Kong so that economic issue or policy of great importance is not to be decided by a commercial company.

Due to the length of the responses, it will be appropriate to summarize them in the table below with the more detailed responses in the following pages under the heading of the relative questions. The summaries will set out the more important titles of the paragraphs in the responses for ease of reading.

Section 2 – An Executive Summary

Summary of Responses

(Please see detailed responses under the heading of relative questions marked in red in the following pages)

Need for and Nature of a Growth Company Market	
Question 1 Page 4 - 5	• Growth Market is a necessity • Violation of the Securities and Futures Ordinance for abolition of GEM • Assumption of the role of the HKSAR Government by HKEx in violation of Article 109 of the Basic Law • Growth Markets in Europe – the European Commission Report • Private commercial interest of HKEx – the IOSCO Consultation Paper
Question 2 Page 6 - 10	• Our Growth Market should serve all types of companies – commitment of open market under the Basic Law • Battle among European stock exchanges as listing place for growth companies across the European continent • Monopoly operations – the IOSCO Consultation Paper • Visions and strategies of the successful Growth Markets in serving growth companies • Hong Kong – a QFII centre or an international financial centre • Serve all growth companies and serve them innovatively
Question 3 Page 11	• Companies at all stages of development should be admitted to the Growth Market – in the sector where they belong
Question 4 Page 12 - 13	• Core investor - Growth Market is not a place just for the angel • GEM - a place where even professional fears to tread
Question 5 Page 14 - 16	• The best regulatory regime for our Growth Market is a competitive one • Growth companies should be allowed access to the low cost market • Competition ensures low public capital cost and social cost – past history of our competitive regulatory regime tells
Possible Structural Options	
Question 6 Page 17 - 19	• Preemptive structural options of HKEx on Growth Market not suitable • An alternative option – over-the-counter Growth Market using Automated Trading Services independent from HKEx
Question 7 Page 20 - 22	• The preferred structural option for GEM is subject it to competition
Question 8 Page 23	• The Basic Law commits Hong Kong to remain an international financial centre – set up a new “not for-profit” OTC Growth Market for GEM and its issuers for solution
Question 9 Page 24	• OTC Market to accommodate the delisted companies
Other Issues	
Question 10 Page 25	• Profile of the listing board determines the profile of the listed companies
Question 11 Page 26	• Proper but not more information to be provided by growth companies
Question 12 Page 27	• Market making should be permitted for both Growth Market and the Main Board

Section 3: Responses and Comments

Need for and Nature of a Growth Company Market

Q1. Is there a need for a growth company market in Hong Kong?

- **Growth Market is a necessity**

  Unless growth company is not allowed to go public in Hong Kong, there must be a market for its shares to be listed for raising capital and the investing public to trade. The Growth Market is the place of first time access to public financing for growth company and indispensable as the lowest gear of the Hong Kong economic vehicle.

- **Violation of the Securities and Futures Ordinance for abolition of GEM**

  It will be a violation of the Securities and Futures Ordinance ("SFO") to abolish GEM without establishing an alternative facility identifying where "high investment risk attached" shares are listed. The statutory requirements for protection of investors must be taken into account when a change in the market system is contemplated particularly when the change will head towards the direction of increasing systemic risk.

  Some of the requirements for protection of investors are set out in the statutory regulatory objectives of the Securities and Futures Commission ("SFC") in section 4 of the SFO as -

  (a) to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;

  (b) to promote understanding by the public of the operation and functioning of the securities and futures industry;

  (c) to provide protection for members of the public investing in or holding financial products; ……..

  (e) to reduce systemic risks in the securities and futures industry; …….

  GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached according to section 2.12 of the GEM Listing Rules.

  The present categorization of markets between the Main Board and GEM helps to reduce systemic risks by making it transparent, promoting the understanding to the investing public about the market listing the "high investment risk attached" shares and has constituted a precedent in compliance with the statutory obligations for protection of investors under the SFO. Any change in the market system must be compensated by setting up an alternative risk identifying facility if the SFO is not to be violated.

- **Assumption of the role of the HKSAR Government by HKEx in violation of Article 109 of the Basic Law**

  Growth Market is an important economic issue worldwide. A change in policy relating to Growth Market shall mean a fundamental change in the status of Hong Kong as an international financial centre which must be dealt with by the HKSAR

Government under Article 109[1] of the Basic Law in addition to the impacts on the future development of Hong Kong's financial industry and environment as well as the livelihood of its workers. Replies to the questions of this Paper should not be given in the light merely desirable and beneficial for HKEx which is a general commercial company[2]. There is no co-incidence of the interest of the financial industry of Hong Kong vis-à-vis the commercial interest of HKEx.

- **Growth Markets in Europe – the European Commission Report**

  High-growth and innovative companies are considered important worldwide to drive economic growth. Their importance in the European economy and the competition for their IPO business by the financial markets have become a cross border pan-European issue. The report "Improving opportunities for Initial Public Offerings on growth stock markets in Europe" of the workshop held on 24 May 2005 in Brussels by the Directorate-General for Enterprise and Industry of the European Commission[3] provides valuable information on how the European Union ("EU") attempts to improve the financial environments for growth companies. Hong Kong is a financial centre and aims to serve internationally. Any structural change in our Growth Market should be reviewed for its impacts on the public interest and coordinated by the HKSAR Government likewise. The policy should not be influenced due to its slowness under the management of a commercial firm without undergoing test by other operators.

- **Private commercial interest of HKEx – the IOSCO Consultation Paper**

  The consultation paper issued by the International Organization of Securities Commissions ("IOSCO") in March 2006[4] has included a review about stock exchanges to withdraw from some market sectors in which they cannot operate sufficiently profitably following their demutualization and conversion into for-profit entities. The demutualisation at last draws attention internationally about balancing the interest of stock exchange as a profit making corporation and the role that it plays in the economy as a place for raising capital and the rational allocation of resources. The way that HKEx handles the slowness of GEM comes under the perfect timing for both local and international scrutiny. A solution seeking only the commercial interest of its shareholders hurts not just Hong Kong's financial industry but confidence of the international investors as well. The inability to gain a sufficient mass, diversity of companies and investors to maintain a Growth Market will also backfire on the whole of our financial industry and even on our capability to maintain the status as the eighth largest stock market in the world.

---

[1] Article 109 The Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre.

[2] Para. 3(2) & (5), Mem. of Ass. of HKEx, http://www.hkex.com.hk/exchange/asso/exchange.htm

[3] Improving opportunities for Initial Public Offerings on growth stock markets in Europe - Directorate-General for Enterprise and Industry, European Commission http://europa.eu.int/comm/enterprise/entrepreneurship/financing/docs/report_exit_mechanism.pdf

[4] D.6. Maintenance of unprofitable markets

Consultation Report Regulatory Issues Arising From Exchange Evolution Technical Committee Of The International Organization Of Securities Commissions March 2006, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD212.pdf

Q2. If so, should the market primarily serve local Hong Kong companies, or should it target Mainland-based companies or regional/international companies?

- **Our Growth Market should serve all types of companies – commitment of open market under the Basic Law**

  Article 112 of the Basic Law commits the continuous opening of our securities and futures markets[5].

  The past success of Hong Kong has largely been credited for, and the continued success will depend on, its legacy of laissez-faire and an open economy in which the market leads and the government facilitates as many economists, academics and others[6] have claimed.

  Unlike the US or European markets, there is no parallel cross trading of the Hong Kong shares in other markets (trading in LSE and ADR in US hardly counts for anything). The absence of competition in the Hong Kong shares trading does not mean that we should close our door in a club-like manner and/or restrict the access of growth companies to our stock market by monopolistic practices in outright contradiction to the manifest aim of maintaining Hong Kong as an international financial centre which the HKSAR Government affirms[7] and is its constitutional obligation and to hamper the development of our financial industry.

- **Battle among European stock exchanges as listing place for growth companies across the European continent**

  In Europe, a battle appears to be brewing among Europe's top exchanges (AIM, Euronext's Alternext and Borsa Italiana's STAR etc.) over who will become the leading listing place of smaller companies across the European continent. High-growth and innovative companies are considered important to drive economic growth. Even on the brink of further industry consolidation, the European exchanges are competing for the pan European market place for the growth stocks[8] and to attract more small companies to list on their boards for achieving growth.

  The intensity of competition in Europe ensures that only the most successful and efficient stock exchange will be leading Europe's Growth Market rather than by a decree. Demutualisation of the European exchanges is a measure to strengthen the competitive position of Europe in the world rather than to monopolize. By the same analogy, our Growth Market should be put under the hand of the operator who can prove its viability in Hong Kong under the test of competition and contribute to our status as an international financial centre in providing services to all companies irrespective of national boundaries. The IDD call service of our telecommunication industry has proved beyond all reasonable doubts of the benefits of competition in lowering cost yet forging ahead technological advancement.

---

5 Article 112 No foreign exchange control policies shall be applied in the Hong Kong Special Administrative Region. The Hong Kong dollar shall be freely convertible. Markets for foreign exchange, gold, securities, futures and the like shall continue.

6 Elements Fundamental To Hong Kong's Success, the American Chamber of Commerce http://www.amcham.org.hk/pr/background/elements-fundamental-to.pdf

7 Welcome Message, http://www.fstb.gov.hk/fsb/aboutus/welcome/index.htm

8 Growth shares/stocks shall mean shares issued by growth company in this response.

- **<u>Monopoly operations – the IOSCO Consultation Paper</u>**

  The consultation paper of IOSCO of March 2006[9] contains another review in relation to monopoly operations following demutualization of exchanges and their conversion into for-profit entities. If HKEx closes its door to growth companies either generally or selectively, or prevents other operator in Hong Kong to serve these companies despite of the slowness of GEM, it will be an act of monopoly against the interest of the financial industry of Hong Kong as well as the further development of an open economy on which we have been relying at all times.

- **<u>Visions and strategies of the successful Growth Markets in serving growth companies</u>**

  A comparison of figures with other Growth Markets is given in the Paper to show that GEM is not alone in the small number of listing (para. 31, p.8). For the successful ones, the London Stock Exchange ("LSE") was even reluctant to launch the Alternative Investment Market ("AIM") originally (p.45) and its later success was helped by the marketing efforts of the LSE and the unique culture of the City of London. Also, the characteristic of the TSX Venture Exchange ("TSX Venture") in Canada is that many of its companies are very small (p.47). In fact, there are no requirements even for net tangible assets, earnings or revenue for an Oil and Gas company in order to list on the TSX Venture[10] but there is similarly no minimum market capitalization for a growth company in order to list on AIM - the world's leading market for small, growth companies.

  The NASDAQ is probably the most important and largest Growth Market of the world deriving from where are many of the concepts in serving growth companies. It has a greater trading volume than any other US exchanges which are competing with each other. Yet, apart from a few lines' mentioning, the US model of NASDAQ has not even been suggested as a candidate for the possible structural option in Chapter 4 of the Paper.

  The successes of AIM and TSX Venture lie with their abilities to act innovatively and aggressively in serving the growth companies irrespective of national boundaries under the prevailing competitive economic and political environments.

  Hong Kong has entered into the 3rd phase of its economic development (light industries and financial services being the 1st and 2nd phases respectively) under the new environment signified by the emerging of China as a global economic power. Our market has to face a change just like AIM and TSX Venture experienced before. The actions taken by AIM and TSX Venture to deal with the economic changes amidst strong competitions or adverse business conditions provide a yardstick to measure whether our stock exchange has the same visions and entrepreneurial spirit to face the challenge in the provision of services to growth companies. For this purpose, an account of the underlying factors is more important than figures to understand their visions and strategies in solving problems.

---

9 D.7. Monopoly operation , Consultation Report Regulatory Issues Arising From Exchange Evolution Technical Committee Of The International Organization Of Securities Commissions March 2006, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD212.pdf

10 Your Guide to Venture Public Capital, http://www.tsx.com/en/pdf/GoingPublicOnTSXVenture.pdf

(a) How AIM serves growth companies and becomes successful

i./- Visions and strategies - The LSE supervision, institutional investor base, self policing by nominated advisers ("Nomad") are credited by the Paper for the success of AIM.

While proudly affirming these excellent means, Chris Gibson-Smith**,** Chairman of LSE, gave an account of their visions and strategies to achieve the end of making AIM Europe's equity market for smaller growth companies in his speech during the Risk Capital Summit on 4 October 2005[11], some as below (while its internationalization effort is not mentioned here) -

- ***A long term goal*** - time is needed to build up the momentum and success cannot be achieved overnight.
- ***The goal of a powerful Europe in the global economy*** **–** the opportunities that LSE may share when Europe wants to be powerful and competitive to shape the future of the world.
- ***The need of Europe to mobile capital, distribute risk and allocate fund to its most productive uses irrespective of national boundaries*** - the smaller and medium sized enterprises ("SMEs") account for two thirds of Europe's employment and have the capacity to grow faster and add jobs more quickly. They are an important driving force of economic growth and AIM makes it easy for them to access a wide pool of capital.
- ***The need for a Pan-European platform*** – AIM understands the need of Europe for a tool to enable the European SMEs to become internationally competitive by being capable of delivering efficient access to capital to them, providing a natural exit route for venture capital and private equity, bridging the gap between early stage debt or private equity financing and public equity and debt.

ii./- **The realizable benefits** - LSE has been marketing that AIM is built to provide smaller companies with markets that are specifically designed for their needs. The benefits of listing on AIM as advertised in its website[12] such as the global reputation of AIM, flexible regulations, tax breaks etc do make AIM such a success to the degree that many AIM-listed companies and even some sizeable companies stay there instead of moving up and some have actually moved down from the main market to AIM. The UK government has even had to consider cutting back on some of the generous tax breaks for AIM investors[13].

(b) How TSX Venture serves growth companies and in large number

i./- **Inherent factors** & **government policy** - Canada is a big country across 3 time zones, agricultural, high tech, rich in natural resources yet with a very

11 Risk Capital Summit, 4 Oct 2005, http://www.londonstockexchange.com/en-gb/about/Newsroom/Media+Resources/Speeches/aimforeurope.htm

12 http://www.londonstockexchange.com/en-gb/products/companyservices/ourmarkets/aim/

13 AIM Grows Up, Ed Bowsher, http://www.fool.co.uk/news/comment/2005/c051103a.htm

small population of 32m (around 4 times of Hong Kong). These factors predetermine that most of her businesses will be small when the population has to be scattered over such a vast land. There are about 2 million small businesses in Canada which have been responsible for almost all net job creation, almost two-thirds of private-sector employment and 60 percent of her economic output.

The Canadian government realizes the dynamic role of small businesses amidst the strong global competitions from other industrial countries in the new economy characterized by rapid technological change and innovation[14]. They are most proficient to keep up with change and innovate aggressively yet facing restricted access to capital. Support of small businesses[15] includes measures such as enhancing of access to venture capital financing through the Business Development Bank of Canada and the Farm Credit Corporation from the government.

ii./- Perfect gearing of the financial sector – The Canadian financial sector is keen to grip hold of the opportunities created by such inherent factors and government policy including the realignment of its stock exchanges in 1999 to operate along lines of market specialization between senior and junior equities as well as to compete with exchanges abroad and the new electronic entrants penetrating the Canadian market since that time. Financial institutions are also actively participating in venture capital financing. The TSX Venture acts as an effective exit for the venture capital and seed investors in this regard. The venture capital and the TSX Venture work in an interactive, mutually dependent and complementary manner. This perfect gearing accounts for the large number of listing covering all major growth sectors despite of the strong competitions from the US markets just across the border.

- **Hong Kong – a QFII centre or an international financial centre**

  The determining factor for Hong Kong's continued success as an international financial centre depends on its ability to assist China's financial intermediation according to the paper issued by the International Monetary Fund on 25 October 2005[16].

  The presence of giant American and European securities firms in Hong Kong makes us look international. As China continues with the reforms of her securities market such as the "G" shares starting last year, more "H" shares will enter the Hong Kong market and become constituent stocks of the Hang Seng Index[17]. These international firms will soon find that they will be trading more and able to trade all major Mainland companies shares here without the need to apply to become QFIIs in China as the Hang Seng Index becomes a replica of the Shanghai index.

[14] Small Business: A Progress Report, http://strategis.ic.gc.ca/epic/internet/insbrp-rppe.nsf/en/rd00506e.html
other papers on SMEs in Canada, http://strategis.ic.gc.ca/epic/internet/insbrp-rppe.nsf/en/h_rd00031e.html

[15] Budget 2004, Building an innovative economy for the 21st Century, http://www.fin.gc.ca/budget04/pamph/paecoe.htm
Budget 2005, A plan for growth and prosperity, http://www.fin.gc.ca/ec2005/agenda/agTOCe.html

[16] IMF Executive Board Concludes 2005 Article IV Consultation with the People's Republic of China—Hong Kong Special Administrative Region, http://www.imf.org/external/np/sec/pn/2006/pn0616.htm

[17] 恒指难拒全流通 H 股, 上海证券报 http://paper.cnstock.com/ssnews/2006-2-14/shierban/t20060214_1007749.htm

The program in the trading of the 7 NASDAQ shares remains in "pilot" stage after 6 years, hardly allowing us to claim our market an international one. Growth companies in China seeking an international profile simply bypass Hong Kong completely. If listing of the search engine Baidu on NasdaqNM has not yet been forgotten, 3 companies including Sinosoft Technology[18] have joined AIM just for the first 3 months of 2006. TSX Venture is waiting vigilantly for a piece of the pie[19]. China has once had to rely on Hong Kong to list the "H" shares to obtain freely convertible currency and to learn modern financial management because we are able to serve internationally. At a time when even the Main Board has to be supported by the Mainland companies listing, Hong Kong will further lose its importance if we can only target and serve companies within a very narrow scope.

- **<u>Serve all growth companies and serve them innovatively</u>**

  Instead of taking a retreat after years of slowness, AIM changed its target to growth companies internationally where it took off dramatically in 2000. It has been successful in marketing that AIM is designed to meet the unique needs of smaller and growing companies in whatever type of business, wherever based and sphere of activity. AIM innovatively uses Nomad with devolved authority to decide whether a company is suitable for admission and to provide ongoing advice to an AIM quoted company.

  De-regulation of the capital account of RMB is a foreseeable event as pressures are already surmounting. The heyday of the Hong Kong market as the source of freely convertible currency for the Mainland companies will wither. On the other hand, China's globalization under the WTO and regionalisation under the thoughts of a free trade zone linking China and ASEAN countries will bring about new business opportunities.

  We have reached the cornerstone as AIM and TSX Venture in 1999 in testing our ability to keep up with the changes. In China, Quangzhou has taken the aggressive attempt to move the stock exchange from Shenzhen[20]. The Zhejiang Delta is competing with the Zhuziang Delta with its innovative enterprising spirits.

  The future of our financial industry will depend on whether we are able to build a new market under these new economic environments and to serve all types of companies irrespective of national boundaries by meeting their needs in these regards and with innovative new services and products.

[18] http://www.thelondonstockexchange.com/en-gb/about/cooverview/thesource/sourcenewsarchive/sinosoft.htm

[19] Information for Chinese companies looking for list on TSX or TSX Venture, http://www.tsx.com/china/index.html

[20] 广深金融中心争议升级 http://www.eobserver.com.cn/ReadNews.asp?NewsID=12421

Q3. At what stage of development should companies be admitted to the growth market – at start-up stage, or at a more mature stage?

- **Companies at all stages of development should be admitted to the Growth Market – in the sector where they belong**

Opportunities for investment associate with all stages of development of a growth company, even concepts. Apple Computer began no more than as a garage business. The success of AIM lies with its ability to create an efficient and flexible capital market to allocate capital efficiently to the most active sectors of the economy across continental Europe. The 2-tiered system of TSX Venture recognizes the different financial and operating needs of companies operating in different industry sectors at various stages of development. Their markets are tailored to the needs of emerging companies and the listing requirements focus more on the experience of the management team and the products and services rather than on earnings (i.e. a pre-requisite stage of development). No vehicle can start with a gas tank big enough for a long journey and a successful gas station operator is one to be found at places where fuel is most needed.

A key factor in the success of AIM and TSX Venture is the availability of the specialised pool of investors looking to invest in growth companies and different types of investors can be targeted during the fundraising process. These specialized investors usually take a medium to long-term view in their investment parameters and often have a special interest in the type of company in the sector that it operates. They choose AIM and TSX Venture because they can readily target for their risk and reward profiles growth companies at various stages of development (i.e. tiered or Nomad monitored) in the specific sector as listed.

The requirement of a statement of active business pursuits under rules 14.15 to 14.18 of the GEM Listing Rules for a large bundle of figures for listing in GEM seems demanding but does not require the company to develop towards the definitive sector as stated in its application once being listed. A real estate company turning into a hot air balloon company in an evening upon opening the Pandora GEM box has not been a surprise in the past if anything has to be said for its lack of attraction to the venture capital fund or investor.

Q4 What should be the core investor group for the growth company market – retail, professional and/or institutional? Should the growth company market be restricted to professional and institutional investors only?

- **<u>Core investor - Growth Market is not a place just for the angel</u>**

  The investors of AIM are split evenly between institutional and retail, according to Mr. Martin Graham, LSE director of market services and head of AIM.

  A matured financial market must be able to provide a full range of products to serve the needs and objectives of various investors, whether aggressive or conservative. After all, investor who has an appetite in speculative investing can find futures, options and warrants readily at his figure tip in Hong Kong. The average investors are more sophisticated than before though not without exception. A retail investor who is doing his own due diligence is not necessarily worse off than investing through a collective investment scheme in Growth Market managed by professional. Investor should have the choice of making his own investment decision. At least, growth stock is not a derivative product with short life span and it can be a potential long term investment though associated with higher risk.

  The crucial question is to better educate investor about the risks in growth stock investing and require him to have an air-bag before taking the bumpy ride. Market practitioner should be not given a free rein in this wagon as well. The penny stock rule of the SEC[21] in the US provides us a good guideline in investor protection in growth stock investing for which retail investor is not prohibited. Penny stock refers to low-priced (below US$5), speculative securities of very small companies, generally traded over-the-counter as well as on securities exchanges inclusive of the securities of certain private companies with no active trading market. In approving a client for penny stock trading, a securities firm has to set up standard to approve a client such as suitability, experience, financial situation, investment objectives and to furnish the client a document describing the risks of investing in penny stocks in addition to other warnings, plus a two business day "cooling off period" before effecting transactions in penny stocks[22].

- **<u>GEM - a place where even professional fears to tread</u>**

  Efforts are made by AIM to nurture the retail investors about small-cap investing and to demystify it as a game for professional and institutional investor with gifted techniques or skills. The websites of AIM[23] and TSX Venture[24] tell about their functions as in providing growth companies with the early-stage stepping stones in their corporate lifecycles towards graduating to a senior exchange. They work closely with the growth companies in order to help them to enter the public markets because they will be sharing the success of their listed companies and describe them as emerging companies or entrepreneurs.

---

[21] Important Information on Penny Stocks, http://www.sec.gov/investor/schedule15g.htm

[22] Amendments to the Penny Stock Rules, http://www.sec.gov/rules/final/34-51983.pdf

[23] http://www.londonstockexchange.com/en-gb/products/companyservices/ourmarkets/aim/

[24] http://www.tsx.com/en/productsAndServices/listings/index.html

However, once a growth company is listed on GEM, it will be knighted by HKEx as "Buyers Beware"[25] right on the front page of the GEM website rather than the decent name of being a growing one (whether it is big and small or engaged in all industries). A visit to the GEM website seems entering into the lobby Casino Lisboa in Macau with its warning against excess gambling but Caveat Emptor relates to problems with quality unfortunately. Who will rush in even professional or institutional investors fear to tread?

[25] A "Buyers Beware" Market for informed Investors, http://www.hkgem.com/root/e_default.asp

Q5. Depending on your answers to the foregoing questions, what kind of regulatory regime would be appropriate for the growth company market? In particular, should growth companies have low-cost access to public capital, or should they, because of their higher risk, be required to comply with procedures that dictate relatively higher costs than those for Main Board companies?

- **The best regulatory regime for our Growth Market is a competitive one**

  Lots may be said about the flexible regulatory regimes of AIM and TSX Venture, particularly the role of Nomad acting as the AIM company's regulator. Their unique models represent the successful efforts, amidst strong competitions from other exchanges, to find the solution that best satisfies the needs under the prevailing economic and legal environments. The transition of Hong Kong from a light industry to a financial services economy is another example of success of the competitive regulatory regime with the credits belonging to the 4 former stock exchanges.

- **Growth companies should be allowed access to the low cost market**

  The NASDAQ trades the shares of many new, high growth, and volatile stocks and this is partially due to the fact that the listing fees on the NASDAQ are significantly lower than other US exchanges and the same is true for other Growth Markets. Most countries consider that innovative and high-growth companies are needed to order to drive economic growth. The global trend is to assist innovative growth companies through the enhancing of access to the capital market rather than to penalize them by heavy cost. The criteria in testing the efficiency of an economy is the ability to mobilize capital, distribute risk, and allocate fund to the most productive and cost effective use, regardless of market segment. An exchange should facilitate, but not to play the role of market forces in determining, the access of the low-cost public capital to the most efficient users.

- **Competition ensures low public capital cost and social cost – past history of our competitive regulatory regime tells**

  The traditional view of natural monopolies of stock market during the 1970s/1980s regards competition between exchanges comes at the cost of market fragmentation and a reduction of liquidity. It increases search costs for traders as well as execution costs and threatens the efficiency of the overall trading process for it to survive. Our policy maker possibly shared the same view at that time.

  (A) Unification of the 4 former stock exchanges – a social cost prospective

  Merging of the four former exchanges, i.e. the Far East Exchange (est. in 1969), the Kam Ngan Stock Exchange (est. in 1971), the Kowloon Stock Exchange (est. in 1972) and the Hong Kong Stock Exchange as the Stock Exchange of Hong Kong Limited ("SEHK") under the Stock Exchanges Unification Ordinance (Cap 361) (now repealed) took place in 1986. Appendix 1 of the Paper describes the pre-merged situation as that the Hong Kong stock market had four boards at that time. Each of the four exchanges had only a single board, listing requirements were not very standardized and they competed among themselves for listing candidates.

What do we learn from the subsequent monopoly after passing through this important milestone of the elimination of fragmentation? Could there be a difference if the 4 former exchanges were still there with the destructive, client oriented, competition among themselves when we take the following events into account in terms of social cost and public capital cost?

(1) Closure of the market in October 1987

The report from the Hay Davidson Committee appointed to look into the event concluded that the exchange was run as "a private club";

(2) Comments from Mr. Anthony Neoh in May 1998

10 years later, the Stock Exchange of Hong Kong was again criticized by the former Chairman of the SFC [26] as running like a "club for brokers" leading to the eventual demutualisation of the stock and futures exchanges.

We have come a long way through before achieving demutualisation following the unification. Yet while the Growth Market is a contestable issue for market operators worldwide, our Growth Market still seems to be a "private club" issue left to the decision of a listed commercial company, i.e. close it down if it is not profitable.

(B) Revolutions brought by the 4 former stock exchanges through competition – the social and public capital cost prospective

(1) Transition of our economy to financial services – the social cost

Turnover of the Far East Exchange in the late 70s and early 80s soon overtook the Hong Kong Stock Exchange which had been operating for almost 90 years in Hong Kong. The visions, hard works and business acumen of our entrepreneurs laid the foundation of bringing about a transition of our economy from light industries in the 50s and 60s to a financial centre as well as making the stock market easily accessible to ordinary investors.

(2) Initial shape of our Growth Market – the public capital cost

A division of labour between markets (or, 4 boards as stated in the Paper) already took the preliminary shape as most small companies were listed on the Kowloon Stock Exchange for public capital funding.

The NASDAQ began trading on 8 February 1971 as the world's first electronic stock market (which started informally when brokers traded on OTC basis). It was well known for trading many new, high growth, and volatile stocks even now. In fact, this was what the Kowloon Stock Exchange (found 1972) was doing similarly during that time as the main listing place of the small companies. The NASDAQ has made a history[27] in the world of finance while we might have killed the first baby of our Growth Market in the cradle.

---

[26] (1) http://eapp01.sfc.hk/apps/cc/pressrelease.nsf/chi/lkupnewscode/8pr48?opendocument
(2) http://www.findarticles.com/p/articles/mi_m0WDP/is_1999_March_8/ai_54159140

[27] Nasdaq: A History of the Market That Changed the World by Mark Ingebretsen

(C) Establishing a competitive regulatory regime for our Growth Market

The demutualisation by merging and listing stock exchanges in various countries in recent years is a process to strengthen the positions of their national exchanges in order to compete with stock exchanges from other countries where cross listing is common rather than reverting back to monopoly in the capital market. This is also true in Europe even the European Union removes the borders of the European countries. AIM competes with other European exchanges to become the listing place for growth companies in the European continent while targeting the global market as well as cross listing at the same time. It has created the Fast Track[28] to enable companies which have been admitted in other markets to cross list on AIM but not contenting itself as an exchange in the UK.

Hong Kong has already entered into the 3^{rd} phase of its economical development under the shadow of the globalisation of China with even more competitors than ever before but not limiting to the formidable Shanghai and Quangzhou immediately after. The proposed free trade zone linking China and the 10-member Association of Southeast Asian Nations will allow investors there to bypass Hong Kong to enter the China Market directly.

The absence of competition in the Hong Kong shares trading and the merging of exchanges practically revert us back to monopoly and to rely on monopoly for solutions. While the European stock exchanges wage war for the Growth Market, many commentators suspect that we are closing it down in Hong Kong at a very high social cost. While other Growth Markets react aggressively to needs of growth companies by making access to public capital easier for them and at a lower cost, we just tell that we are open minded – or, not knowing what we are heading for.

We have been successful in bringing about 2 economic revolutions in the past by choosing competitive regulatory regime who should again be chosen as our candidate to take over the baton for the 3^{rd} run in the relay of this new economic race, starting with the Growth Market.

---

[28] The Fast Track to AIM, (including, Australian Stock Exchange; Deutsche Börse; Euronext; Johannesburg Stock Exchange; NASDAQ; New York Stock Exchange; Stockholmbörsen; Swiss Exchange; Toronto and others as issued by the UK Listing Authority)

http://www.londonstockexchange.com/NR/rdonlyres/135D6B35-51A3-4FA7-B048-2B2922840FED/0/2293.pdf

Possible Structural Options

Q6. Bearing in mind your responses to questions 1 to 5 above, please comment on the suitability of the following possible structural options for a growth company market in Hong Kong (see Chapter 4 for details on these options):

- **Preemptive structural options of HKEx on Growth Market are not suitable**

  Though "The Exchange has an open mind about these options and welcomes further comments on these or other possible options for GEM, as well as any recommendations that could be pursued independent of the market's structure (para. 59)", the public shall however be "Bearing in mind your responses to questions 1 to 5 above, please comment on the suitability of the following possible structural options for a growth company market in Hong Kong (see Chapter 4 for details on these options)." These preemptions practically mean that responses from the public are limited to the three structural options specified by HKEx as well as its recommendations to the regulator in the later consultation.

  Bearing in mind that HKEx is a commercial company, this is not a suitable question except with the introduction of competition to our Growth Market.

- **An alternative option – over-the-counter Growth Market using Automated Trading Services independent from HKEx ("OTC ATS Growth Market")**

  It is not too early to plan ahead for new venues of business once China de-regulates the RMB together with the elimination of different classes of shares by which time investors can bypass Hong Kong and trade directly within China for Mainland companies shares which represent a large volume of turnover of our market now. Judging from the encouragement for more listing of SMEs in Europe as a way to grow for which China is likely to experience the same in the opening of its economy, we have to consider widening the channel of trading growth shares as one of the new venues and for the reform of our Growth Market towards a competitive one. The US models of the former NASDAQ (before transforming into a stock exchange), OTCCB and Pink Sheets operating without floor space and trading electronically on over-the-counter ("OTC") basis could be considered for our new Growth Market and which shall be owned by another organization instead of HKEx so that they are competitors to each other.

  In fact, the provision of the Automated Trading Services ("ATS") under Division 7 Part III of the Securities and Futures Ordinance allows the establishment of electronic OTC facility like the former NASDAQ for trading securities. ATS is defined as services provided by means of electronic facilities to trade in securities[29] (not being facilities provided by a recognized exchange company). Since ATS is operated electronically and does not require a trading floor, it will lower the cost of trading. In the course of time, it may even be considered for all types of securities not just limited to the growth shares.

[29] Guidelines for the Regulation of Automated Trading Services http://eapp01.sfc.hk/apps/cc/regulatoryhandbook.nsf/lkupMainAllDoc/H198/$FILE/ATS%20(PDF-%20English).pdf

(1) OTC ATS Growth Market – its operator and settlement

This OTC ATS Growth Market may be operated by a recognized securities association or other financial institutions. Growth Market is a business that requires more personal attention. A new market will allow more business opportunities to brokers particularly those in the Category C who are suffering from the pressures of large brokers and banking institutions. The HKEx may offer its CCASS facilities for settlement purpose on DVP basis[30], if it so wishes, or alternatively a centralized and electronically operated depositary may be set up. Interested parties, market practitioners and the industry may pursue this OTC ATS Growth Market with the regulator as a reform of our market and a new venue of business.

(2) Admittance to the OTC ATS Growth Market

Companies admitted to this OTC ATS Growth Market can tentatively be-

- companies delisted from HKEx;
- growth companies from China and overseas companies;
- even private companies (if incorporated in Hong Kong) for which a Schedule 2 of the Company Ordinance has been filed similar to the US OTCCB or Pink Sheet markets, i.e. unlisted market;
- Securities listed on other markets but not intend to seek listing on the Main Board.

If Hong Kong is to maintain the status as an international financial centre, we must be able to think innovatively about our Growth Market with its uniqueness in offering services under the new economic environments. This situation is not peculiar to Hong Kong only as Part D of the IOSCO Consultation Paper has similarly mentioned how other exchanges react speedily to new business opportunities by the moving into unregulated activities that may even blur the line between exchange and OTC activity in expansion of their present services.

(3) ATS – the innovative ones have done it ahead of us

The London Stock Exchange plc, has already been authorized for offering ATS by the SFC[31] as well as others such as TradeWeb Europe Limited, MarketAxess Europe Limited, if we have to understand why innovation is important for the success of the other Growth Markets.

---

30 Rules 703 (Arrangements with other entities), General Rules of CCASS of HKEx, http://www.hkex.com.hk/rule/ccassrule/ccassrule.htm

31 Register of Automated Trading Services Authorised Under Part III of the Securities and Futures Ordinance http://www.sfc.hk/sfc/html/EN/intermediaries/trading/trading/trading.html

(a) GEM as a second board

- This is solely a business decision of HKEx but the second board must clearly identify itself as being a Growth Market and competition must still be introduced. Success of a Growth Market, however, is not just a structural issue anyway.

(b) GEM and the Main Board to merge into a single board:

i. Universal single board – GEM and the Main Board to merge into a single board, with no distinction between them;

- Section 2.12 of the GEM Listing Rules specifies that GEM is a market to accommodate companies in which a high investment risk may be attached. Unless an alternative system is set up for proper identification of such "high investment risk attached" shares, merging GEM with the Main Board knowingly without distinction between them is a violation of section 63(1)(c) and 63(2) of the SFO that the risks associated the business and operations with a recognized exchange controller have to be managed prudently, act in the interest of the public, having particular regard to the interest of the investing public, as well as breaching the regulatory objectives imposed on the SFC by section 4(e) regarding reduction of systemic risk in the securities industry.

ii. Tiered single board – GEM and the Main Board to merge into a single board with the growth market forming the lower tier and the existing Main Board the upper tier. Further tiers might be introduced as well.

- This suggestion is just another structural re-arrangement and solutions for the slowness of GEM cannot rely merely on the tools. After all, as a listed commercial company, HKEx has to make its own business decision. Nevertheless the tiered structure within the Growth Market similar to TSX Venture is a plausible arrangement since it reflects the stage of development of a growth company and should be adopted for the proposed OTC ATS Growth Market as well.

(c) New alternative market – GEM to merge into the Main Board, and a new market with an enhanced regulatory regime to be launched for growth companies.

- The Singapore Stock Exchange has already gone a further step ahead of Hong Kong about adopting the AIM model. While this is still a business decision of HKEx, it does not seem to make any difference between the present GEM/Main Board arrangement with their own listing rules and trading on the AMS3 at the same time. Again it must not be an excuse to prevent the entry of a new competitor into the Growth Market.

(d) Others – do you have any other suggested structural options for GEM?

- HKEx may consider to spin off GEM or to set up a subsidiary company to operate it so that it is not a stumbling block in the course of its Main Board's business. There must however still be 2 competitors so that there is a better chance of success for our Growth Market under the force of competition.

Q7. Based on your preferred structural option for GEM, do you have any specific views or recommendations concerning:

- **<u>The preferred structural option for GEM is subject it to competition</u>**

  AIM was considered a failure late as August 1999. Rather than taking a retreat, AIM changed its course overseas towards internationalization from 2000 onwards and made a dramatic take-off therefrom. Now it competes to make itself the equity market place of the growth stocks in Europe. It competes also on listing cost which is just 4.5-5 percent of the fund raised comparing with 6-8 percentage of NASDAQ attracting even US companies to its board. The determination to keep up with change, to compete and to innovate aggressively account for its success to reverse the tide while Nomad plays the role of a capable crew without doubt. There is no royal way to success and the cut-throat competition among the 4 former stock exchanges has helped Hong Kong to transit from a light industrial economy to financial services. Accordingly any structural option for GEM must subject it to the test of competition by the introduction of a new competitor into our Growth Market. If HKEx spins GEM off, 2 competitors should be allowed to take up the business to ensure the existence of competition in our Growth Market.

(a) the targeted issuers (eg type of business, stage of development) and investors (eg retail, professional, institutional),

- Both the suggested OTC ATS Growth Market and the GEM of HKEx should operate in competition with each other and admit the same types of companies as in Q6, i.e.

  Companies admitted to this OTC ATS Growth Market can tentatively be-

  - companies delisted from HKEx;
  - growth companies from China and overseas companies;
  - even private companies (if incorporated in Hong Kong) for which a Schedule 2 of the Company Ordinance has been filed similar to the US OTCCB or Pink Sheet markets, i.e. unlisted market;
  - Securities listed on other markets but not intend to seek listing on the Main Board.

- All types of investors should be allowed to this new OTC ATS Growth Market and GEM of HKEx but penny stock rules similar to SEC in the US could be adopted so that only investors with suitable experience and the ability to bear losses/risks will be approved for trading under the more aggressive/risky market conditions suggested here.

(b) the regulatory approach,

- The business environment of Hong Kong and the future targeting of the market in China may make the tiered structure of TSX Venture a better choice so that investors can understand the stage of development of a company. There shall be a graduation system for a company in the lower tier to move to the higher tier when it grows up.

- There should be differences in filing requirements between the higher tier and the lower ones with proper trade-off between frequency and nature of information to be provided or similar to the US OTCCB and Pink Sheets markets.

(c) the initial listing requirements and the listing process,

- The suggested new OTC ATS Growth Market should be operated by a securities association or financial institution to be authorized by the SFC as an ATS provider and will be responsible to review the listing documents for listing in this OTC market. It may have the same devolved authority to vet the prospectuses or listing documents of such companies similar to Chapter 11A of the Listing Rule of the Main Board.

- A company delisted from HKEx should be allowed to transfer to this OTC ATS Growth Market for immediate trading without submission of any form of listing document.

- For the lower tier, the more flexible approach of the US OTCCB / Pink Sheets markets may be adopted such as the Reg A, D filings which depend on the amount of offer and voluntary filing by the smaller companies (though much controversies will be expected in this suggestion).

(d) the process of ongoing regulatory supervision,

- A large number of smaller companies listing in a Growth Market will drain up the regulatory resources. Ongoing regulatory supervision will have to be more and more relying on professionals of the market in the same way as the innovative use of Nomad by AIM for helping to achieve fair, orderly and efficient trading though greater flexibility has to be allowed for in the Growth Market regulation.

  In the course, we will build up a culture of our own – the culture that will enable Hong Kong to serve China's market more effectively because of our knowledge and expertise in addition to creating more jobs for our industry. Setting up of Compliance Adviser by SEHK is the correct approach for this purpose and it should be used amply for our new Growth Market as well.

(e) the disclosure and corporate governance requirements, and

- Our Growth Market should provide an alternative to growth company with a flexible yet appropriate approach to corporate governance while entrenching the principles of transparency, accountability, fairness and responsibility.

  The mistakes caused by the huge cost of compliance for small companies under Sarbanes-Oxley Act as the aftermath of Enron in the US must not be repeated.

  No longer is there a dispute for every listed company to have a website which is available at a minimal cost nowadays on which it should publish all regulatory filings for investor's information and must have an Investor Relationship tab to account to investors for its business activities and investment projects.

(f) the roles of sponsors and other professionals?

- At the time when governments everywhere outsource their non-vital functions to the private sectors, the same should be true for the securities industry when more listings are made on the stock exchange. AIM is the best example in making Nomad the regulator of AIM companies. Nomad knows the business by being the market people themselves. It helps to improve quality of the market while releasing much of the regulatory burden on the exchange and the regulator at the same time.
- The use of professionals to regulate listed companies will lower regulatory cost which shall be borne by the listed companies themselves and avoid the statutory regulator to grow unwieldily large or for more transaction levies. Further use of sponsors and professionals should be encouraged in the same way as AIM exports the concept of Nomad to Europe.

Q8. If you consider that there is no need for a growth company board in Hong Kong, what should be done with GEM and its existing issuers?

- **The Basic Law commits Hong Kong to remain an international financial centre– set up a "not for-profit" OTC Growth Market for GEM and its issuers for solution**

  Article 109 of the Basic Law requires the HKSAR government to provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre. There is no reason why a Growth Market cannot exist in Hong Kong while other major exchanges struggle for growth company business.

  A change in the policy relating to the Growth Market, i.e. its existence or abolition, will mean a change of the status of Hong Kong in this regard. This is not a question merely for the market users and interested parties but rather an economic policy of extreme importance inclusive of Hong Kong's role in China's economy. Possible issues arising could be; whether Hong Kong will continue to play an international role in the future; the division of functions in securities business between Hong Kong and China's stock exchanges etc. The International Monetary Fund has said that the determining factor for Hong Kong's continued success as an international financial centre depends on its ability to assist China's financial intermediation. There will be doubts in our ability if we cannot even maintain a Growth Market.

  In the present instance, there is no better choice or answer than the setting up of a new OTC Growth Market to accommodate the existing GEM companies and their issuers if HKEx is no longer interested in GEM. The existence of competition, such as the OTC ATS Growth Market proposed here, will maintain continuity as a competitor is ready to take up the business if the other quits. There are other advantages by using the electronic OTC trading for the Growth Market which can be operated by a broker association or financial institution. Operation cost will be kept minimally low since there is no floor space and traded electronically. Traders (who must be SFC registered persons) will be joining the trading network freely and provide their only trading facilities apart from clearing electronically through a central settlement agent. Each node of the trading network will be bearing its own costs and there shall not be any profits concern as HKEx in running this new Growth Market. Together with the new services and products, Hong Kong may be able to enter into a new chapter of its securities business just like AIM in 2000.

Q9. What, if anything, should be done with delisted companies? Should there be a separate market for trading these companies?

- **<u>OTC Market to accommodate the delisted companies</u>**

  The penny stock panic in 2002 as a result of the issue of the consultation paper to de-list the low-price and loss-making companies has indicated once again how monopoly had hurt our market without the existence of competitor. The TSX Venture has setup the NEX as a new trading forum for listed companies that have fallen below TSX Venture's ongoing listing standards (which accordingly should be considered as acting in a responsible manner).

  Delisting of a loss making company in China will require first putting its shares under a Special Treatment (ST) status and then to Particular Transfer (PT) status after making losses for 3 consecutive years upon which time the shares will be suspended from normal trading but can be transferred once a week. Time is allowed for both the company to re-organize its business and its investors to exit from their investments upon giving up the final hope in the company. The ST and PT treatments have been in place early as 1998 and 1999.

  Also an investor in US shares will be able to trade seamlessly even if his shares are delisted from an exchange. The OTCCB market[32] is ready to accept trading and provide quotations for securities delisted from NYSE, AMEX, NASDAQ, even securities issued as part of a bankruptcy plan of reorganization as well as others. If an issue has been delisted from NASDAQ because it has not maintained NASDAQ's listing requirements and the security meets the specified criteria, then the issue will be available for immediate quotation on the OTCCB from market makers. Quotations of the OTCCB and Pink Sheets stocks[33] are readily available electronically.

  The ability to exit from an investment is equally important as its entry for investors and is the test of the capability of a market in attracting investors. The US model proves so effective in serving both functions and it should be one of the structural options for our Growth Market.

  Accordingly the answer to this question is the same as Q8 in the setting up of a new OTC Market, which can be the OTC ATS Growth Market as proposed in this response, to accommodate the delisted companies.

---

32 The OTC Bulletin Board, http://www.otcbb.com/aboutOTCBB/overview.stm#abouthistory
33 About The Pink Sheets, http://www.pinksheets.com/about/index.jsp

Other Issues

Q10. Do you have any suggestions on how to raise the profile of companies listed on the growth company board?

- **<u>Profile of the listing board determines the profile of the listed companies</u>**

  3 per cent of AIM companies have gone bankrupt in its nearly 11 years of existence. The SEC warns about the risks in penny stock investing and there was the notorious Enron fiasco in the US main market. The TSX Venture has to use NEX to house companies that have fallen below TSX Venture's ongoing listing standard.

  Investors will go to markets where they see prospects and liquidity is high and will not be hindered by failure of individual companies in such markets.

  Similarly a growth company expects that a heightened public profile can be achieved by listing on a prestigious exchange so as to enhance liquidity in its shares, to maintain the loyalty of existing shareholders by giving a valuation to their investment and to increase its ability for expansion by using its shares as currency. This will depend on the success of its listing board to maintain itself the focus of the investors while performance of the company itself plays the complementary part. Both AIM and TSX Venture emphasize their increasing scope, prestige and the distinctive profile as an effective natural exit route for venture capital and private equity, for bridging the gap between early stage debt or private equity financing and public equity – a shopping mall of listed growth companies for investors.

  The profile of NasdaqNM as a famous Growth Market was apparently the reason for joining by BAIDU which was made known worldwide in reciprocation by the price of its shares. Profile of the listing board as a place where investors can readily shop for the right growth companies is the determining factor in raising the profile of its listed companies.

  Despite of what aforesaid, HKEx has already warned buyers to beware the GEM companies.

Q11. Should more information be provided on growth companies? If so, what information, and who should provide it?

- **<u>Proper but not more information to be provided by growth companies</u>**

  For growth stocks where ownership is mainly the entrepreneurs founding the companies, their families and public shareholders, the cost of compliance in providing information in the same standard as the main market will outweigh the benefits of listing. For institutional investors, they are able to evaluate performance by their analysts or other professional means. The experience in the US of the Sarbanes-Oxley Act after the collapse of Enron has proved it a mistake in its strict prescriptive approach to all companies. In the UK, the Combined Code does not apply to AIM companies which are then benefited from a more flexible and adaptable governance regime. A successful Growth Market is not built on more information from the growth companies though filing of proper information is no doubt their obligations.

  For a 2-tiered market, the senior tier should observe higher standards in the provision of information similar to those set out in Chapter 17 (Continuing Obligations) of the present GEM Listing Rules. The lower tier should be allowed a more flexible submission for which the OTCCB / Pink Sheets markets of the US or the TSX Venture may be adopted.

  Again when the Growth Market is enlarged, professional should be more relied on to assist the growth companies in the regulatory filing and disclosure in similar manner as Nomad in AIM.

Q12. Should market making be permitted on the growth company board? If so, what should be the obligations of and incentives provided to market makers?

- **Market making should be permitted for both Growth Market and the Main Board**

Market making should definitely be permitted like all major markets including the Main Board. It is an important factor to make the market active and liquid as well as providing trading convenience to retail investors. US shares can be bought and sold even for 1 share easily due to the market making system and there is no reason why investors in Hong Kong shares should be deprived of the same facility. Though market making is not allowed in China's stock exchanges, Article 125(5) of the Securities Law allows a securities firm to take up proprietary position (subject to specified capital requirement) which will help to improve liquidity of the market. According to the industry, there is no lack of interest of local brokers to become market makers for small companies with good prospects.

Market makers inevitably have to take up proprietary positions and their remuneration in making market for growth shares will necessarily be the wider spread in price range. Incentives similar to the Registered Traders of the Futures Market may be considered for the market makers (if an aggressive approach is taken). Promotion of growth shares to institutional investor is likely to be on OTC basis for most of the time with large spread in price. Under the AMS3 trading system of HKEx, the transaction will have to be executed on direct crossing basis which is likely to invite investigation from the regulator when the amount of transaction and price spread are large. The incentive in growth shares is lacking accordingly under the AMS3 system which handles both the Main Board and GEM shares at the same time and monitored in the same way. In this regard there should be more flexible regulation on the market making in the same way as the growth shares are listed. Also under the existing Financial Resources Rules, growth shares are given zero liquidity and relaxation can be given for transactions between market makers for obtaining temporary financing (though large hair-cut may still be applied).

It must be admitted that higher risk is attached to growth shares, market makers may possibly be required to maintain proper contacts with the listed company's Compliance Adviser and to carry out due diligence on regular basis until experience is gained on the market making system for an alternative arrangement. They must maintain continuous quotes or respond to quote requests as part of their obligations for companies that they make a market.